



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **200833022**
Release Date: 8/15/2008

Date: May 21, 2008

Uniform Issue List:
501.00-00

SE:T:EO:RA:T:2

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: March 14, 2008

Uniform Issue List:
501.00-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

M =
Q =
R =
S =
T =
U =
V =
W =
X =

A =

State 1 =

State 2 =

Date =

Date 2 =

x =

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Facts:

You, M are a State 1 nonprofit corporation formed on Date. You were originally incorporated as T. Q, a State 1 nonprofit exempt under 501(c)(3) with the purpose of lessening the burdens of government with the funding of public and semi-public buildings and works sponsored your creation. Q states that it has no ongoing relationship with any real estate developer or property manager.

Your application states that Q had been approached by various colleges and universities to assist in the development of student housing. In order to avoid conflicts with Q's existing activities and because of specific requirements to qualify for tax exemption, Q was instrumental in your creation to develop these projects and to limit its liability.

Your revised application was submitted Date 2 with the purpose of advancing education by providing housing for enrolled students of public and private colleges and universities. Your Articles of Incorporation states that you are organized and operated "to advance, support, promote, and assist schools, colleges and universities fulfill their educational purposes, to aid students at such institutions in attaining an education, and to foster community development" by:

1. providing housing for enrolled students of public and private nonprofit colleges and universities lacking adequate facilities for such purposes, in collaboration with such institutions and with the communities in which they are located, and to sponsor, encourage, promote, advance and otherwise assist with the provision and improvement of housing facilities for students of such institutions;
2. providing financial assistance to such institutions or the communities in which they are located, to the extent funds are available for such purposes; and
3. providing housing scholarships and general scholarships to low-income students, to the extent funds are available, and otherwise provide educational assistance to students supplemental to college and community activities, including working with prospective students in low-income areas to help them locate additional financial aid for tuition, books, housing and fees.

Your primary activity is to own and operate student housing for colleges and universities through disregarded entity limited liability companies (LLCs).

You state that you will meet with representatives of interested communities and educational institutions to determine the need for housing. If there is a need for housing, you will form an LLC to own and operate each such project. You will be the sole member of each LLC and each LLC will constitute a disregarded entity for tax purposes. You state that each LLC will have a five-member management board including one member from the college or university where the housing project is located, two community members, and two members selected by Q. You state that the articles of organization for each LLC will include the name of the related college or university and the purpose of providing housing for the related college or university, which cannot be changed without unanimous consent of the LLC board.

You state that each LLC will purchase and renovate existing housing property or convert property to student housing; or will purchase the land and construct and develop housing facilities. Each housing facility will be owned and operated by the LLC and the facility will be managed by the educational institution or by an unrelated property management company. The student housing facility will be rented to students enrolled at and attending the educational institution. You state that, "to the extent that funds are available from the operation of the facility after payment of operating costs and debt service, any net cash flow will be contributed to the supported college or university or the city in which the educational institution is located, or used to fund scholarships for low-income students or subsidize rent or other living expenses of low-

income student renters, based on income eligibility test, or some combination of the above." You further state that each LLC will submit periodic written reports to the college or university supported and to the local community regarding planned activities and goals for future periods and past performance in meeting previously established goals.

The first LLC you created is R, a State 1 LLC. The information you submitted including the LLC organizing document and operating agreement provides that the purpose of R is "to support, assist and benefit S by providing student housing, and funding or providing funds for academic and/or housing scholarships for students and/or providing funding or to provide funds for academic and/or housing scholarships for students attending a university in the State 1 or who are residents of the State 1." You have not conducted any market study or feasibility study to confirm the need for student housing at S.

S is a public land-grant institution located in State 2. You state that you are collaborating with S and city, along with proposed developers, V and W and property manager, X to develop a student housing project that will be owned and operated by R.

You state that the housing facility will be financed through the issuance of tax-exempt bonds, the proceeds of which will be loaned to R pursuant to a Loan Agreement. The bonds will be secured under a mortgage and security agreement. You state that S is under no obligation to repay the bonds. You state that the rental rates will be set at an affordable level but sufficient to cover the operating expenses and debt service on the bonds.

You state that you will enter into a Support Agreement setting forth the specific obligations of R to assist and support S in providing housing by developing, constructing and operating housing facilities, and covenants of mutual cooperation and participation between R and S. Pursuant to paragraphs 1 and 2 of the draft Support Agreement, R is, among other obligations, responsible for developing and operating the facility in a manner that is consistent with the student life plans and student housing properties owned and operated by S. The eligibility criteria for this housing project includes student enrolled at classes at S, persons attending a program presented or conducted by or on behalf of S, or any member of the faculty or staff of S. In your letter dated October 11, 2007, you state that student life plans are developed by S and that R will afford S an opportunity to provide information to its renters, but that no information has been prepared to date.

Paragraph 3 of the draft Support Agreement describes S's obligations which include: providing in its distribution materials, a description of the project to students seeking housing, allowing advertisements through S's website, etc., providing temporary space to lease housing, providing M with access to S's network and agreeing that S will not acquire or construct or permit the acquisition or construction of any additional student housing for S's exclusive use or under any other arrangement within a 3 mile radius of the facility within 5-years of occupancy.

The Support Agreement states a partnership or joint venture is not created by this agreement and that "S has the right to review and confer with R" on decisions made with respect to the management of the project, including any changes to the manager, operating budget, capital expenditures, marketing, rental rates, etc. In addition, S has to the right to appoint a consultant to make recommendations regarding the operation, management and promotion of the project that are consistent with S's master plan and business operations, which R is obligated to follow.

However, the Support Agreement also states that "S has no right or responsibility regarding the operations of R or the project which are completely independent of S."

Finally, S has the option to purchase the property at any time for the price of \$x plus the amount necessary to provide for defeasance of all bonds and the payment of any other amounts owed by R with respect to the project. Upon final repayment of all financial obligations, you state that you will "donate" the property to S or to any other University-designated 501(c)(3).

In your letter dated October 11, 2007, in response to a question requesting a description of S's role in the development, construction, management, and financing of the housing project, you stated the following:

While S does not intend to own the project (it does have the option to purchase the project under section 5 of the Support Agreement), given the location thereof and its option to purchase, S does have a substantial interest in having the project meet its architectural and building standards. It intends to satisfy those interests by engaging a consultant to "watch over" the planning and construction of the project. This function should not have any effect on the ability of R to finish the project. The rights of S set forth in Section 4 and elsewhere in the Support Agreement are intended to insure that the project is beneficial to the University and its students and meets the need for student housing that currently exists.

Your business and affairs are currently managed by an Executive Director, who is also the executive director of Q and a member of U, the property manager. You have entered into a management services agreement with U to administer day to day operations. The terms of the management agreement provide that U will provide managerial assistance to you. You state there is no business or family relationships between U and either you or R. However, U also serves as the administrative manager for Q and you state that you expect this relationship to continue.

Your Board of Directors consists of five (5) persons who are the same directors as Q. You state that Q has the authority to appoint all of your directors. You further state that "because of this appointment authority and the overlap of directors between the boards of Q and M, it is anticipated that a working relationship between Q and M will continue."

Law:

Section 501(c)(3) of the Internal Revenue Code provides, in part, that an organization is exempt from Federal income tax if it is organized and operated exclusively for charitable purposes, and if no part of the net earnings of the organization inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the advancement of education as well as relieving the poor, distressed or underprivileged, lessening the burdens of government, and promotion of social welfare by organizations designed to lessen neighborhood tensions, eliminate prejudice and discrimination, defend human and civil rights secured by law, or combat community deterioration and juvenile delinquency.

Section 509(a)(2) of the Code provides that an organization will be a public charity (and not a private foundation) if it normally receives more than one-third of its support in each taxable year from gross receipts from performance of services or furnishing of facilities, among other, in an activity which is not an unrelated trade or business and not more than one-third of its support from gross investment income.

Rev. Rul. 63-220, 1963-2 C.B. 208, describes a corporation that was organized primarily for the purpose of extending loans to needy students of a college to enable them to complete their educational programs. Certain loans were granted on an unsecured basis, while others required a type of security. Both types of loans were made at the same nominal rate of interest which was substantially lower than commercial interest rates, thereby representing a substantial saving to the students. The ruling holds that such activity serves a charitable purpose by making loans available to students at substantially less than commercial rates. The fact that under certain circumstances security is required before a loan may be granted is not sufficient to destroy the charitable aspect of the organization's purposes and activities

Rev. Rul. 64-274, 1964-2 C.B. 141, describes an organization that provides free housing, scholarships, and books, to students who could not otherwise attend college because of a lack of funds. The Service ruled that under these circumstances, the organization was exempt because it was advancing education by relieving the poverty of the students.

Rev. Rul. 67-217, 1967- 2 C.B. 181, recognizes an organization formed to provide housing and food service exclusively for students and faculty of a specific university lacking such facilities as exempt under section 501(c)(3) of the Code. The housing facility was constructed by the organization on land near the university and made available to the students of the university at rates comparable to those offered by the university in its own facilities. While the facility was run by a commercial management company, any surplus from operations was donated to the university and the university had an option to purchase the facility at any time for an amount equal to the outstanding indebtedness. Providing the housing under these circumstances served to advance education.

Rev. Rul. 76-336, 1976-2 C.B. 143, describes an organization formed by community leaders to provide housing for students of a particular college in response to studies by staff members of the college showing that the college lacked suitable housing to meet the needs of students. The college was financially unable to provide housing. Additionally, many of the students in its primary service area live at such a distance that daily commuting is not reasonably possible. The organization operates a housing facility for students adjacent to the college campus. All students of the college are eligible to apply for the housing. Applications for housing are accepted on a first come-first served basis. Charges to students for the housing approximate costs, including debt retirement. The organization is not controlled by the student residents or by the college. However, the college and the organization consult and cooperate to ensure that the needs of the college and its students are served by the operation of the housing facility. The organization is governed by a board of directors composed of community leaders. The organization's income is from rentals of the housing facilities and from contributions. Its disbursements are for operating expenses and debt retirement. The ruling holds that the organization provides needed student housing that is not otherwise available. All students who attend the college are eligible to apply for residence. Under these circumstances, the

organization is both helping the college, which is unable to provide adequate student housing, to fulfill its educational purposes, and aiding the students to attain an education. Therefore, the activities of the organization are advancing education.

In Better Business Bureau of Washington, D.C. v. U. S., 326 U.S. 279 (1945), the court held that an organization was not organized and operated exclusively for charitable purposes. The court reasoned that the presence of a single nonexempt purpose, if substantial in nature, would destroy the exemption regardless of the number or importance of truly exempt purposes.

Analysis and Conclusion:

You have failed to establish that your operations will further a charitable purpose and that you will not be operated for a substantial nonexempt private purpose. Providing housing for students in the manner you have described, absent special facts and circumstances, is a trade or business that is not a charitable activity.

An organization providing student housing may qualify for exemption if certain facts and circumstances are present. For example, serving a class of students recognized as a charitable class. However, you do not restrict your services to a charitable class of students such as low-income. Nor do you provide free housing or below cost services. Providing services at cost and solely for exempt organizations is not sufficient to characterize the activity as charitable. See Rev. Ruls. 63-220 and 64-274, *supra*. In addition, you have also failed to establish that you will provide any other charitable activities to the affiliated educational institutions.

Unlike Rev. Ruls. 67-217 and 76-336, *supra* where exemption was based primarily on the element of control by or on behalf of an exempt organization and providing assistance to specific colleges, your primary purpose is to provide financing and housing services to a number of colleges and universities. You plan to establish a series of limited liability companies to operate each housing facility. This structure prevents you from being controlled by any one educational institution or by any one community. Instead, you are an independent organization not created by the community or in conjunction with the educational institutions that you intend to become "affiliated" with. While you plan to include members of the community and the university on the board of the local LLC, there is no evidence that members of the local community or directors of the educational institutions will have any significant involvement in, contribute to, or otherwise participate in your actual operations. As stated in your Support Agreement, S, the university has no oversight over the operations of R, the LLC and in fact the operation of the housing facility is independent of the university..

Finally, your role is primarily that of developer. You are operated for the substantial nonexempt purpose of marketing and designing projects and to act as a vehicle for financing the projects through tax-exempt bonds. The essential facts and circumstances of both Rev. Rul. 67-217 and 76-336, community control, college involvement and below cost operations are absent from your structure and operations. Your overall structure is designed to be self-supporting without regard to the educational institutions you are servicing. Such activity is not an exempt activity, but a trade or business.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service
TE/GE (SE:T:EO:RA:T:)

1111 Constitution Ave, N.W.
Washington, DC 20224

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements